

BASIC PAYROLL INSTRUCTIONS

Payroll - The distribution of pay to employees. Whether you generate three checks at a typewriter or 3,000 checks through a computer system, there are many laws and regulations that determine what is paid, how much, and what is withheld. This chapter will cover, in highlight form, the laws that govern payroll and their application. It will also provide a glossary of terms used commonly in the payroll field.

The Commonwealth of Kentucky is identified to the Federal Government as one employer. Each agency is a representative of the Commonwealth in processing payrolls and complying with all the applicable laws. Each of the applicable laws has certain obligations which must be filled by the employer. Heavy penalties can be imposed on employers and in some cases employees for failure to comply with payroll laws. In practice, the burden falls on the payroll officers to see to it that the employer does what is required under the law. Thus, it is essential to become familiar with laws mentioned in the following text.

The following laws affect the state's payroll:

1. Federal Income Tax (FIT) Withholding by the Employer.
2. Kentucky Income Tax (SIT) Withholding by the Employer.
3. Local Income Tax (LIT) Withholding by the Employer.
4. Federal Social Security and Hospital Insurance Taxes (FICA & Medicare).
5. State Unemployment Insurance Tax Law.
6. Federal Wage-Hour Law (FLSA).
7. Equal Pay Law.
8. Federal Wage Garnishment Law.
9. Federal Child Support Law.
10. State Child Support Laws.
11. State Wage Garnishment Laws.
12. State Wage and Hour Laws.
13. Merit Laws and Regulations.
14. Federal Immigration Reform and Control Act of 1986.
15. Workers' Compensation.

Each of these is highlighted below.

1. Federal Income Tax Withholding by the Employer

Federal Income Tax Withholding is set forth by the provisions of the Internal Revenue Code of 1986 (IRC). The IRC requires employers to withhold Federal Income Tax from each wage payment made to employees. The amount of withholding must be made in accordance with the employee's W-4 (Withholding Exemption Form) and the applicable withholding rate. Payments to employees are exempt from Federal Income Tax Withholding in a limited number of situations. These exemptions include, but are not limited to:

1. Payments made, through payroll deduction, into one of the state's retirement systems, such as the Kentucky Employee's Retirement System.
2. Payments made, through payroll deduction, into the Kentucky Employees Deferred Compensation Plan, or other annuity plan as described in IRC:403;
3. Wages paid to employees who have filed a W-4 (Withholding Exemption Form) which certifies they have no tax liability; and
4. Payments to a decedent's estate for wages due, but not paid until after death. (Contact IRS for questions.)

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2. Kentucky Income Tax Withholding by the Employer.

Employers incorporated in, qualified to do or doing business in the state or subject to Kentucky jurisdiction must withhold Kentucky Income Tax, as provided in 103 KAR 18:010. The amount of withholding is determined in accordance with the employee's withholding exemption certification (Form K-4) and the tables or computer formula prescribed by the Kentucky Revenue Cabinet. Wages subject to Kentucky Income Tax are the same wages subject to Federal Income Tax. However, under reciprocal tax agreements, wages earned in Kentucky are exempt from Kentucky withholding if the employee is a resident of Illinois, Indiana, Michigan, Ohio, West Virginia or Wisconsin, or the employee resides in Virginia, and commutes daily to work in Kentucky. These employees must file Kentucky Form 42A809 to exempt such non-residents from Kentucky withholding. (Contact Revenue with questions.)

3. Local Income Tax Withholding by the Employer.

Kentucky municipalities and counties may pass ordinances to require an earnings tax (or license fee) to be withheld on employee's wages. In most cases, all compensation earned for services performed in the municipality or county are subject to withholding. Rates vary according to the individual ordinance. (See appendix for local tax list and rates.)

4. Federal Social Security and Hospital Insurance Tax.

The Federal Insurance Contribution Act (FICA) Tax was established to maintain a federal system of old-age, survivors and disability benefits. This act provides for two separate taxes, social security tax and hospital insurance tax (Medicare). These taxes apply to both the employee and the employer. Employees in covered positions are subject to both taxes (FICA). Employees, whose positions previously were not covered by social security, and who were hired after March 31, 1986, are subject to only the Medicare Tax. (Those employed prior to March 31, 1986 in non-covered positions are not subject to either.) The tax is withheld on all compensation, up to the taxable wage base for the year as set forth by the Social Security Administration. There are few exclusions to this tax. However, one that applies to Kentucky Government is wages earned, but not paid, until the year following an employee's death. (Questions should be address to the State Office for Social Security). Also, effective January 1, 1987, employee's retirement contributions are exempt from FICA.

5. State Unemployment Law.

The Kentucky Unemployment Law, adopted in 1936 and strengthened over the years, was designed to assist in maintaining a healthy economy. By offsetting part of the wages lost when an individual is unemployed, the Commonwealth promotes economic stability. Employers are required, under KRS 341.070, to report quarterly the wages paid to employees in Kentucky and to pay their share of the Unemployment Tax. State Government pays this tax as well as other employers in the state. (Questions should be addressed to the Department for Employment Services, Division of Unemployment Insurance.)

6. Federal Wage-Hour Law (FLSA).

The Fair Labor Standards Act of 1938, as amended, established minimum wage, overtime pay and child labor standards for employment subject to its provisions. In 1985, the Supreme Court extended coverage under this Act to state and local governments (*Garcia v. San Antonio Metropolitan Transit Authority*). This law provides that covered employees (those not in executive, administrative, or professional positions) must be paid overtime at one and one-half times the employee's hourly rate for all hours over 40 worked in any workweek. Substitution of compensatory time is allowed when awarded on a basis of one and one-half hours

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compensatory hours earned for each one hour worked over 40. Special note: The Personnel Regulations established under KRS Chapter 18 do not allow the substitution of compensatory time for paid overtime. (Questions to the Wage and Hour Division of the U.S. Department of Labor.)

7. Equal Pay Law.

The Equal Pay Act provides that no employer subject to the FLSA can discriminate between employees on the basis of sex by paying wages at a different rate for equal work on jobs requiring equal skill, effort, and responsibility, and performed under similar working conditions. (Questions to the Wage and Hour Division of the U.S. Department of Labor.)

8. Federal Wage Garnishment Law.

The Federal Garnishment Law limits the amount of an employee's disposable earning which may be garnished in any one week, and protects employees from being dismissed because of garnishment for any one debt. Garnishment means any legal or equitable procedure through which earnings of any individual are required to be withheld for payment of any debt. It refers to court proceedings through which a creditor seeks to reach an employee's earnings before they are paid, so that they may be applied in satisfaction of a claim against the employee. The restrictions on the amount that may be garnished do not apply to child support orders, bankruptcy orders under Chapter 13 of the Bankruptcy Act, and debts due for federal and state taxes. (Questions should be addressed to the Wage and Hour Division of the U.S. Department of Labor.)

9. Federal Child Support Law.

The Child Support Enforcement Amendments of 1984 provide that each state must have laws in effect setting procedures for the withholding from income for support payments. The amendments also require state child support enforcement agencies to automatically initiate wage withholding when the parent ordered to pay support falls behind in an amount equal to thirty days of support. State wage withholding laws must comply with the Federal Statute for both in-state and out-of-state child support cases being enforced through the federal/state child support enforcement program. The law also prohibits any disciplinary action of any kind because of the support withholding requirement. (Questions should be addressed to the U.S. Department of Health and Human Services, Office of Child Support Enforcement.)

10. State Child Support Laws.

Kentucky Revised Statutes conform with the Federal Child Support Enforcement Amendments of 1984, with the addition of the following specific provisions. The employer is bound to begin withholding as soon as the notice is served. The employer is subject to a \$500 fine and a one-year prison term for non-compliance. (Questions should be addressed to the Department of Social Insurance, Division of Child Support Enforcement.)

11. State Wage Garnishment Laws.

The Kentucky Revised Statutes conform to the specific requirement of the Federal Wage Garnishment Law, with the following exceptions: The exempt wages shall be the greater of 75% of disposable earnings or 30 times the federal minimum wage. The employer who doesn't follow garnishment procedures may be subject to contempt proceedings. The State Garnishment Law does not apply to child support payments, levies for state or federal tax debts, and bankruptcy court orders. (Questions should be addressed to the Revenue Cabinet.)

12. State Wage and Hour Law.

The Kentucky Revised Statutes provide for the same minimum wage, and overtime provisions are the Federal Wage and Hour Law. (Questions should be addressed to the Kentucky Department of Labor.)

13. Merit Laws and Regulations.

Chapter 18 of the Kentucky Revised Statutes sets forth the structure of the Merit System. It also establishes the provision of control through payroll certification, which prohibits the making or approving of any payment for service to any person unless that person has been appointed and employed in accordance with the provision of the Kentucky Statutes and the orders thereunder. Chapter 18 also provides for the Personnel Cabinet to issue administrative regulations, which relate to the salary which may be paid and the types of payments which may be issued to state employees. These payments include, but are not limited to, annual leave payments, sick leave payments, suggestion awards, and educational achievement increase payments. (Questions should be addressed to the Division of Administration & Processing, Personnel Cabinet.)

14. Federal Immigration Reform and Control Act of 1986.

The Immigration Reform and Control Act of 1986 prohibits employers from hiring aliens not authorized to work in the U.S. and requires employers to maintain an employment verification system for any employee hired after November 6, 1986. A form designated by the Immigration and Naturalization Service is required to be completed by each employee to certify that they are eligible for employment. In addition, documentation presented by new employees must be examined, recorded on the designated form, and the form signed by the employer's representative. Such forms must then be retained for three years or for one year past the end of employment of the individual, whichever period is longer. Civil and criminal penalties will be imposed on employers who hire unauthorized aliens. (Questions should be addressed to the Immigration and Naturalization Service.)

15. Workers' Compensation Temporary Total Disability Checks

According to 101 KAR 2:100 Section 2(12), the employee's absence due to illness or injury for which Workers' Compensation benefits are received for lost time, sick leave may be utilized to the extent of the difference between such benefits and the employee's regular salary. Under no circumstances should an employee receive more pay than his normal salary for that period. The payroll officer is responsible to ensure that this does not occur. Upon receipt of the Workers' Compensation check, the payroll officer would determine if the employee was entitled to receive the check by the following guidelines:

1. If the employee utilized leave for the entire period, the Workers' Compensation check would be signed over to the State to reinstate leave. To determine the number of hours to reinstate, the payroll officer would divide the Workers' Compensation check by the employee's hourly wage rate and reinstate that number of hours to the employee's leave balance.
2. If the employee was placed on leave without pay for the entire period, the employee would be entitled to receive the entire Workers' Compensation check.
3. If the employee utilized leave and was also placed on leave without pay for a portion of the period, the Workers' Compensation check and the employee's payroll check would be added together to determine if the total would exceed the employee's normal salary.
 - a. If the two checks do not exceed the employee's normal salary, the employee is entitled to receive both checks.
 - b. If the two checks do exceed the employee's normal salary, the amount in excess of the normal salary must be paid back to the State to reinstate leave. The amount in excess is divided by the employee's hourly wage to obtain the number of hours of leave to reinstate to the employee's leave balance.

2.B. Glossary of Terms

Bond Alternate Name	A name associated with a U.S. Savings Bond, other than the employee's, such as a co-owner or beneficiary.
Change Indicator	A column on UPPS transactions immediately preceding a data field. This indicator field must contain an "X" in order for the information in the field following to be applied to the payroll record.
Check Distribution Number	A 5 character field, contained in the employee's payroll record, used to sort checks for distribution.
COBRA	The Consolidated Omnibus Budget Reconciliation Act of 1985.
Company Number	A 5 digit number used to identify the individual agency in Kentucky State Government. The first two digits identify the cabinet, and the last three digits identify the department.
Covered Employees	Workers whose services and wages are subject to a particular payroll law. Employees covered under one payroll law are not necessarily covered under other payroll laws.
Deferred Comp	Refers to the Kentucky Public Employees Deferred Compensation System. This system allows for payroll reductions for a tax sheltered retirement supplement program.
E.F.T.	Electronic Fund Transfer. Sometimes referred to as "Direct Deposit". A system used by State Government which allows employees to have their paychecks deposited directly into their checking or savings account.
E.I.N.	Employer Identification Number, used to identify an employer to a governmental unit.
Employee Number	Employee's Social Security Number.
Employee's Withholding Allowance Certificate	Also known as "Form W-4", which the employee submits to the employer showing the number of allowances claimed. It serves as the employer's basis for withholding Federal Income Tax.
Exempt Employees	Workers who perform services and receive wages that are not subject to a payroll law. Employees who are exempt under one payroll law are not necessarily exempt under other payroll laws.
Fair Labor Standards Act	See Section on Federal Wage-Hour Law.
FICA	Federal Insurance Contributions Act (provides for the withholding of Social Security Tax).
F.I.T.	Federal Income Tax (See Chapter Two for discussion).
F.L.S.A.	Fair Labor Standards Act (and amendments).
Garnishment	A legal procedure authorizing a deduction from an employee's earnings to satisfy a debt.

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Gross Pay	The total amount of wages, tips and other compensation paid to an employee.
I.R.C.	Internal Revenue Code
I.R.S.	Internal Revenue Service
Kentucky Employee's Withholding Exemption Certificate	Also known as "K-4 Form", which the employee submits to the employer showing the number of allowances claimed for State Tax Withholding. It serves as the employer's basis for withholding Kentucky State Income Tax.
Labor Distribution Number	A combination of digits used to indicate how the employee's payroll costs are to be charged.
Left Justified.....	A method of completing transactions by entering characters in a particular field as far to the left as possible. Used primarily for alphabetic fields.
L.I.T.....	Local Income Tax. Sometimes referred to as "City Tax", "Occupational Tax" or "License Fees". (See Chapter Two for discussion).
Magnetic Tape Reporting.....	An alternate method to filing paper returns and forms for employers with computerized payroll systems.
Manual Pay Transactions	Transactions used to update the UPPS payroll record with information relating to redeposited checks or checks generated by a payroll voucher. These transactions would also update information relating to refunds issued for taxes withheld in error.
Medicare	A two-part Federal insurance program for people 65 or older and certain disabled people. Tax to provide this coverage is withheld as a part of FICA. It is also withheld from state employee's wages who were hired after March 31, 1986 into positions exempt from FICA.
Months of Service	The number of months that an employee has worked for State Government and earned annual leave. (See sick months of service.)
Pay Period	The period of service for which the employer pays wages to the employees. In state government, the pay period is semimonthly.
Payroll Deductions	A term used to cover a wide scope of withholdings from an employee's paycheck. Included in this are retirement (both the employee and the employer share), group life insurance, state paid life insurance, and health insurance.

2.B. Glossary of Terms

Percentage Method of Withholding	A procedure for calculating the amount of tax withheld using mathematical formulas, usually intended for employers with computerized payroll systems. The IRS and jurisdictions that require withholding of income tax may have different computerized methods for withholding.
P-1	The personnel action form used by Kentucky State Government.
Revenue Ruling	Rulings issued by the Internal Revenue Service representing the conclusions of the service on the application of the law to specific cases. Revenue rulings do not have the force and effect of Treasury Department regulations, but they may be used as precedents.
Right Justified	A method of completing transactions by entering characters in a particular field as far to the right as possible. Used primarily for numeric fields.
Shift-Differential	A premium paid in addition to an employee's regular base pay for working on second or third shift.
Sick Months of Service	The number of months that an employee has worked for State Government and earned sick leave (See Months of Service).
S.I.T.	State Income Tax. (See Chapter Two for discussion).
Supplemental Payrolls	Payrolls, whether generated by payroll voucher or supplemental computer system payroll run, which produce checks in addition to those produced during the regular payroll period processing.
Taxable Wage Base.....	The maximum amount of wages subject to Social Security or Medicare Taxes.
Time Card Status	An indicator in the UPPS payroll system that indicates whether an employee requires a pay transaction to be entered in order to receive a pay check.
T.I.N.	Taxpayer Identification Number. For an individual, this is the individuals Social Security Number. For a business, this is the Employer Identification Number (EIN).
U.I.	Unemployment Insurance.
UPPS	The acronym used for the State's personnel and payroll computer system, the "Uniform Payroll and Personnel System".
Wage-Bracket Withholding Method	A procedure for determining the amount of income tax to be withheld using wage-bracket tables. These tables are classified by payroll periods and the employee's marital status.

2.C. Who are Employees and What are Wages

Who are Employees?

Any worker who receives compensation for services is either an independent contractor or an employee. It is important to understand the difference, as the employer's liability for withholding payroll taxes differs. An employee is an individual who performs services subject to the will and control of the employer, both as to what shall be done and how it shall be done. An independent contractor performs services, but has ultimate control of both the method and the result of these services. In application, obviously, an individual who is appointed with a P-1 is an employee. An individual who has a personal service contract (whether the contract provides for social security or not) is an independent contractor. What about the mass of individuals who do not fall into one of these categories?

A general test to determine if an employer-employee relationship exists is to ask three questions. 1. Is the worker free from control over his performance? 2. Is the service provided outside the regular course or place of the employer's business? 3. IS the worker customarily in an independent business? If the answer to the three questions is "yes", then the individual is an independent contractor.

An employee must be considered under all the applicable payroll laws and the appropriate taxes must be withheld. The employee's wages, tips, and other compensation are reported on a W-2, wage and tax statement form. The independent contractor is not considered under the payroll laws, and the payments made (unless there is social security coverage) are reported on 1099-Misc, statement for recipients of miscellaneous income.

What are Wages?

Wages are compensation, in money or other form, for services performed. Wages paid in State Government will be in money form, with the exception of fringe benefits (such as personal use of a state-provided vehicle). Wages consist of payments not only for hours worked, but also for paid leave time, employee suggestion awards, educational achievement increase payments, reimbursement for meals, shift differentials, backpay awards due to court or Personnel Board orders, and any other miscellaneous payment issued.

How much of what is considered "wages" is taxable? This varies under the various tax laws. The following chart shows the applicable taxes to be considered for each type of payment.

Type of Pay	Fica/Med.	FIT	SIT	LIT	UI
Pay for Hours Worked (Regular and Overtime)	X ₁	X	X	X	X
Paid Leave	X ₁	X	X	X	X
Employee Suggestion Award	X ₁	X	X	X	X
Educational Achievement Increase	X ₁	X	X	X	X
Reimbursement for Meals		X	X		
Employer-Provided Vehicle	X ₁	X	X	*	
Shift-Differential	X ₁	X	X	X	X
Backpays (Court or Board Ordered)	X ₁	X	X	X	X

1-Up to the Taxable Wage Limit for that Calendar Year.

*-Some Local Tax Ordinances include Fringe Benefits. Check the Specific Ordinance.

2.D. Types of Payrolls in State Government (Manual & UPPS)

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There are two types of payroll processes in State Government. The first is a computer-based payroll system referred to as UPPS (Uniform Payroll and Personnel System). UPPS is run by the Personnel Cabinet, Division of Administration & Processing.

UPPS is run four times each month. There is a regular payroll run, usually on the fourth working day of the pay period. This regular run produces the paychecks to be distributed on the 15th and the 30th. There is also a supplemental payroll run, submitted before payday, to pay employees who were missed on the regular payroll run.

The second type of payroll process is manually-prepared payroll voucher. This voucher is referred to as a DOA-27, which references the Division of Accounts form number assigned to the voucher document. A DOA-27 can be prepared and submitted for processing any time during the pay period. However, since this document requires special handling and manual calculations, it is recommended that a DOA-27 only be used when absolutely necessary. When a manual payroll is processed, update transactions must be submitted to add the manual information to the employee's payroll record maintained in UPPS.

Instructions for preparing both types of payrolls are covered in this manual (See Chapter 7). For questions which may arise, and are not addressed within, there are two separate contacts. Questions on UPPS should be referred to the Payroll Audit and Assistance Section, Room 535, 5th Floor, 200 Fair Oaks Lane, Frankfort. Questions on DOA-27 preparation should be referred to the Division of Accounts, 4th Floor, Capitol Annex, Frankfort.